

Friday, August 2, 1974

Dear Member:

All this week economists talked to Congress and the press. Out of the cacophony came one message on which they all agreed: Learn to live with sluggish growth, it'll be around for a while.

Their point: It's the best thing the economy can hope for. Slam on the brakes now to push inflation and interest rates down, they argue, and the country will careen into a major recession.

Under the best of circumstances business will remain soft, inflationary fires not fully banked, interest rates still high. But some kind of tolerable balance can be maintained among them.

That balance will determine the adjustments business makes. The adjustments, of course, won't be the same for every business. Some firms' profits are booming, others face materials shortages.

But generally, business will have to live with costly money. Nor is the outlook for widened margins or expanded sales strong. Best advice is hold your own, lighten your debt load if you can, step up efficiency, tighten your belt to live with modest profits. It isn't a cheery scenario, but it's far from the worst possible.

For investors, best bet still is: Use liquidity to make money. Quite simply, cash is now the most precious commodity in the world. Given U.S. and global capital demands, the opportunity for profit on quick turnover of short-term lendable funds is "good as gold."

Those floating rate notes of Citicorp and Chase Manhattan, upcoming issues of some other banks, and of Standard Oil of Ind., are the clearest signal yet given of the dearth of loanable money. Obviously, they're betting money rates won't come down fast soon.

Fact is the economy is in a desperate scramble for new money. The long-term bond market is near dead with little hope of revival until the current short-term crunch is over -- months, maybe years. Even then, competition for funds will stay keen because of demand.

It adds up to living with inflation and high interest rates, at stabilized and tolerable levels, or risking a deep recession. Given current uncertainties, even a sluggish economy looks good.

It is hard this week to avoid the impression of a doomed man: The President's fortunes have begun a sudden, precipitous slide, almost as if the dikes have burst and threaten to sweep him away. It's not substance that's changed so much as the mood of Congress.

The agony of the impeachment process was laid bare on TV,

like a series of Norman Rockwell portraits, for all to observe. The public perception of the Judiciary Comm. was of serious men, bent on a serious, onerous task, deeply determined to do right.

Across the nation the drama was experienced as a catharsis, something that tested the fiber of the system and found it firm. There is a pervasive sense of faith restored in U.S. institutions, a greater readiness to accept impeachment, if it comes, as a need.

But, unhappily, behind the facade politics as usual goes on. Fact is, Washington has always been a cruel and ruthless place. When the power brokers smell a vacuum, they move in with dispatch.

Thus while the White House mood was grim, morbid, dispirited, across the street in the Executive Office Building the play began: Some pros started treating Jerry Ford as if he were Pres.-elect. Talk at political hangouts turned to the makeup of a Ford Admin.

There is, first of all, the choice of a new Vice President. Political wisdom says Ford must pick a man more liberal than he is. Names most commonly heard include Rockefeller, Elliott Richardson, Senators Brooke, Mass., Percy, Ill., and Brock and Baker, Tenn.

Richardson has the broadest experience within the government. He is considered a poor campaigner, but many say that's a plus now. His biggest handicap is the fierce opposition of Nixon loyalists, still angry at what they feel is his part in the Pres.'s troubles.

Rockefeller matches Richardson's broad government experience. is now acceptable to party pros and to the GOP's conservatives. Though he still has ambitions for the Presidency, his age helps. Some believe he is too old to fight for the top once he's Veep.

The Senators cited all have liabilities as well as pluses. Brooke is black and the country may not be ready for a black V.P. Percy is bright and liberal but an outsider disliked by party pros. Brock & Baker rank with the long shots: Lightning may strike them.

Nor is the game limited to prospective Vice-Pres. possibles. Ford's new cabinet is being laid out for him -- piece by piece. The cold-blooded pros are already telling him he needs a new team, shouldn't make the LBJ mistake of hanging on to the old courtiers. If you operate, they say, make surgery quick, avoid hemorrhages.

Those who know Ford best say Mel Laird will be the kingpin. He's an old friend and mentor from Congress, a savvy politician. Paradoxically, his advent could lose Ford Dr. Kissinger's service. Kissinger's and Laird's differences cut deep, are hard to resolve.

Nor is it clear that Ford will get along with Schlesinger. Aides Haig, Ash and Rush are too identified with Nixon to stay. Rumors haven't touched HEW's Weinberger, Treasury's Simon as yet.

There is more to all this, however, than mere gamesmanship.

If Ford becomes President -- and we aren't yet persuaded he will, are only reporting to you about Washington's political mood -- his Admin. would be his own, not a carbon copy of the Nixon gov't. Most likely, it would be low-key, down home, very Middle American.

The compromise pension bill is ready for the House & Senate, will be voted quickly as soon as the text comes off the presses. And chances of a veto are virtually nil, making enactment sure.

RIA analysts have been going through the preliminary drafts, will have detailed reports on both the tax and nontax sections of this important new law as soon as possible after it is signed.

Meanwhile, businesses will have time to adjust practices. The effective date of most sections -- on participation, vesting, funding, etc. -- is 12/31/75. And where collective bargaining over pensions is involved, the deadline may be delayed further.

Only one major feature will be effective upon enactment: the gov't-run pension insurance program. Employees, in fact, will be protected against failure to pay retroactive to 7/1/74. But employers won't have full liability until the law is signed.

Wholesale revisions of the National Income & Product figures have caused consternation among economists in & out of government. They've blown sky-high many "explanations" of economic behavior, since what was being explained apparently just didn't happen.

More important, they raise serious questions about policies adopted or recommended to deal with situations that didn't exist. And they reflect very badly on the quality of all gov't data.

Biggest changes have been made in inventories and savings. These have long been the most unreliable of all statistics -- have often been used as "dumping grounds" for the inconsistencies between purchases and sales, and between incomes and spending.

On savings, the poor quality of the data is being compounded by the misinterpretation of the new figures in much of the press. "Consumers saved more in 1973," you've been reading this week. Fact is, the sharp upward revision in the "personal savings rate" had very little to do with how much consumers have been saving.

Even accepting the new income, spending & savings figures -- which isn't an open-&-shut question, analysts have learned -- here's what they seem to show happened in 1973 and early 1974:

"Total personal income" in '73 was some \$20 billion higher than originally figured, while personal spending was unchanged. Result is that "personal savings" were also \$20 billion larger, for a whopping 36% increase over the estimates published earlier.

But here's the joker: "Personal," in the gov't statistics, means "noncorporate," includes proprietorships, farmers, others, along with the figures for all of the people on wages & salaries. This doesn't affect the totals much, but can cause most variation.

And in 1973, virtually none of the upward income revision was in wages & salaries -- what most think of as consumer income. Nearly 2/3 of the entire increase was in farmers' net incomes, which the gov't now says jumped by over 80% from 1972 to 1973.

Personal savings also include proprietor & farmer "savings." And just about all the upward change was in these two categories. So, individual consumers didn't save more in 1973, after all -- in fact, may have saved less than thought, as a % of incomes.

What's happening now, to the real rate of consumer savings? Both the old & new figures agree that the trend has been down, since the end of last year. And that direction is probably right, as incomes have failed to keep pace with the cost of living.

Long-run experience has been that consumers tend to maintain their spending patterns for a time, after their incomes change. And in today's climate, that means smaller additions to savings.

Tax reform: Some action in the House this fall seems likely, once impeachment fever shifts to the Senate side of Capitol Hill. The House Ways & Means Comm. has readied a small reform package, wrapped attractively enough to make House passage a good prospect.

Key items include higher standard deductions to aid the poor, a substantial hike in the minimum tax, from \$10,000 to \$30,000, and a cut in the top rate on unearned income from 70% to 50%. The rationale for the latter move is to encourage investments.

None of the other proposals come closer to being profound, are tailored to attract votes in Congress -- and on the hustings. Slowly lawmakers realize they must bring home at least some bacon, show the electorate they are aware of problems that hurt the most.

Much more doesn't seem to be in the legislative cards yet. Even if the House passes the package, Senate outlook is gloomy. The Finance Comm. won't handle it during an impeachment trial -- quite aside from Chairman Long's leisurely approach to any reform.

Nevertheless, the trend of House tax action bears watching. It's just possible, for one thing, that "stampede" bills may pass, especially if the economic news turns very bad in Sept. and Oct. For another, the current exercise is a training session for '75. We do expect the next Congress to get serious about tax reform.

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